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June 11, 1992

VIA NETWORK AIR COURIER

Ms. Donna R. Searcy, Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Re: Comments of Sheppard, Mullin, Richter & Hampton on Mass Media Docket No. 92-51

Dear Ms. Searcy:

Enclosed for filing are the original and nine copies of the Comments of Sheppard, Mullin, Richter & Hampton on the Review of the Commission's Regulations and Policies Affecting Investment in the Broadcast Industry.

Questions or correspondence with respect to this matter may be directed to or Richard L. Sommers of this office or me.

Very truly yours,

David Isenberg

for SHEPPARD, MULLIN, RICHTER & HAMPTON

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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C.

In the Matter of	)	
	)	
Review of the Commission's	)	**MM Docket No. 92-51**
Regulations and Policies	)	
Affecting Investment	)	
in the Broadcast Industry	)	

To: The Commission

COMMENTS

OF

SHEPPARD, MULLIN, RICHTER & HAMPTON

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Dated: June 12, 1992

COMMENTS OF SHEPPARD, MULLIN, RICHTER & HAMPTON

The law firm of Sheppard, Mullin, Richter & Hampton ("Sheppard, Mullin") hereby submits comments in response to the Federal Communications Commission's ("Commission") Notice of Proposed Rule Making and Notice of Inquiry (MM Docket No. 92-51). The Commission has requested comment on certain issues related to the granting of security and reversionary interests in broadcast licenses. In particular, the Commission has requested comment on the following three questions, among others:

1. What effect will holding a security or reversionary interest in a license have on the likelihood that a creditor will attempt to exercise control or have substantial influence over a borrower's station?

2. Will allowing security interests in broadcast licenses discourage lenders from helping stations work past temporary financial difficulties?

3. What are the legal implications of an application of the holding in In re Welch, 3 F.C.C.R. 6502 (1988) to broadcast licenses vis-a-vis the Uniform Commercial Code?

As will be seen below, these questions raise substantially similar issues in the context of a workout of a troubled banking relationship between a broadcaster and its bank lenders.

The Current Legal Environment.

To fully appreciate the impact of the Commission's current policy on security interests in broadcast licenses, certain principles of bankruptcy law and debtor-creditor law must be explored, so that their impact upon the lender's overall approach to working out a troubled broadcaster creditor can be understood.

The Commission has historically taken the position, as a matter of policy founded upon the Federal Communications Act, that a broadcast license, as distinguished from a broadcaster's plant or physical assets, is not an owned asset or vested property interest so as to be subject to a mortgage, lien, pledge, attachment, seizure or similar property right. Underlying this position is a public policy determination that the hypothecation of a broadcast license endangers the independence of the licensee who is and who should be at all times responsible for, and accountable to the Commission in the exercise of, the broadcasting trust. See In Re Applications of Kirk Merkley, Receiver, 94 F.C.C. 2d 829, 830-831 (1983). Also underlying the Commission's policy is the basic understanding that a broadcast license evidences a privilege held by the broadcaster and not an entitlement in which the broadcaster holds property interest vis-a-vis the Commission.

The Commission's policy with respect to liens in broadcast licenses was recently reaffirmed in a matter entitled In Re Omega Cellular Partners, 5 F.C.C.R. 7624 (1990). In that matter, the Commission explained its understanding of the lending environment to be that "it is well established . . . that the Commission does not recognize a security interest in a license and that credit can not be extended in reliance upon the license as an asset from which a licensee's obligations may be satisfied." Omega, 5 F.C.C.R. at 7624.

The Lender's Expectation of Repayment.

As the Commission knows, the traditional way to value a broadcast licensee is as a multiple of cash flow. This results in a value, and therefore a sales price, which dramatically exceeds the value of the broadcaster's tangible and intangible (other than the license) assets. However, is the purchase price which broadcast lenders finance. Therefore, virtually all loans to broadcasters which are used to acquire new signals dramatically exceed the value of available UCC-type collateral.

In the case of a healthy broadcast borrower, the deviation between the value of the station as a going concern and the value of the underlying available collateral is of minor importance because the lender, in addition to its liens, typically has an enforceable bilateral contract agreement with the borrower which requires the borrower to deliver to the lender for application to the loan the proceeds of an assignment of the broadcast license. Further, under a standard broad form of security agreement, a lender would normally have

an Uniform Commercial Code security interest in agreements entered into by the broadcaster borrower which concern assignment of the broadcast license to a new licensee. The security interest is in the assignment agreement itself and is not a security interest in the license. Thus, the security interest does not in any way affect Commission control over the assignment process, or give the lender any ability to interfere with underlying assignment transaction. Rather, the lender is merely entitled to collect the compensation to be paid to the assignor by the assignee at the time that the transaction closes.

The Effect of Broadcaster Bankruptcies

As the broadcast industry has experienced a substantial downturn, together with the rest of the economy, a number of broadcasters have been forced to commence proceedings in bankruptcy court in an attempt to reorganize. This phenomenon has focused courts and the broadcast finance community on the effect of the Commission's rule concerning security interest on the lender's ability to recover on its loan to a broadcaster in bankruptcy.

When the broadcast borrower goes into bankruptcy, the broadcast lender is exposed to a dramatic restructuring of the underlying debt. On the whole, reviewing bankruptcy courts have determined that the secured lender of a broadcaster has neither lien on the broadcast license nor in any right or interest attributable thereto. See, In Re Tak Communications, Inc., 138 B.R. 568 (W.D. Wis. 1992); Matter of Smith, 94 B.R. 220 (N.D. GA 1988).

Once a broadcaster declares bankruptcy, the lender loses both its contract right to the proceeds of an assignment and its UCC lien on any assignment agreements that the debtor may thereafter enter into. The automatic bankruptcy stay established under Bankruptcy Code Section 362, together with the automatic rejection of financial accommodations provided for under Bankruptcy Code Section 365(c)(2), result in a lender being unable to enforce its pre-existing contract rights to collect the proceeds of the sale of any broadcast facility in satisfaction of the loan. Further, under Bankruptcy Code Section 552, security interests which are granted by the borrower to the lender pre-petition do not survive the filing of the bankruptcy. The filing of the bankruptcy petition cuts off the effectiveness of pre-petition granted liens as to property acquired by the borrower after the bankruptcy petition is filed. As a result, the secured broadcast lender is deprived of the ability to enforce its security interest against the proceeds of a post-petition assignment agreement, a right which the secured creditor clearly would have had prior to the filing of bankruptcy.

The holdings in Tak Communications and In Re Smith have very significant ramifications when they are applied to questions concerning the valuation of a secured creditor's claim under Bankruptcy Code Section 506. Under this provision, a Chapter 11 debtor can ask the Bankruptcy Court to value the collateral held by a secured creditor. If the debt exceeds the value of the secured creditor's collateral, the amount of the creditor's secured claim can then be reduced by the court to the value of the collateral. The balance of the lender's claim becomes a general unsecured claim in the bankruptcy proceeding.

Valuation of the Lender's Collateral and its Impacts

The full impact of the Commission's policy concerning the unavailability of liens in broadcast licenses is illustrated in the bankruptcy case entitle In re Oklahoma City Broadcasting Co., 112 B.R. 425 (Bankr. W.D. Okl. 1990). In that case, the bankruptcy court was called upon to value the claim of the bankrupt broadcaster's secured bank lender. Because the lender had no lien on the broadcast license, the bankruptcy court refused to value the assets on a going concern basis and refused to attribute any goodwill type value to the collateral in which the lender had a lien. Rather, the court restricted the value of the lender's claim to the liquidation value of the assets in which the lender had a perfected Uniform Commercial Code lien. The court specifically found that the difference in value between the tangible assets of the broadcaster and the broadcaster as a going concern was attributable to the broadcast license and therefore outside of the purview of the lender's collateral. See, Oklahoma City Broadcasting Co., 112 B.R. at 430. The implication of this valuation was to render a substantial portion of the debt unsecured.

As to the unsecured portion of the debt, the lender is subject to bankruptcy priority rules and must share in proceeds with other unsecured creditors on an equal basis. Bankruptcy Code Section 507 establishes a priority scheme of distribution of available assets of the debtor's estate. This priority scheme includes eight categories of priority claims which are paid in full prior to payment of any money to the general unsecured claims. Pre-petition tax obligations of the borrower hold a priority position and will be paid out of

proceeds prior to payment on the lender's unsecured claim. Even worse, should the station be sold by the broadcaster in bankruptcy, and should the broadcaster realize any meaningful appreciation above the broadcaster's pre-petition tax basis, the resulting capital gain received by the broadcaster will be subject to taxation, which tax will be a first priority unsecured claim under Bankruptcy Code Section 503(b)(1)(B). The impact of taxes is important because, in bankruptcy, a secured lender would normally expect to recover from collateral ahead of payment of the borrower's tax liabilities.

The Impact of Current Policy on Lender/Borrower Relations.

Because the impact of bankruptcy upon the lender's ability to recover the loan is so potentially devastating, lenders typically work very hard to avoid bankruptcy in the case of broadcast borrowers. However, the avoidance of bankruptcy should not be interpreted as a willingness to extend unusual time or efforts to the resolution of a troubled credit. Rather, broadcast lenders often act aggressively in the case of troubled broadcast credits to win the "race to the courthouse" and thereby take control of a troubled broadcaster borrower prior to the commencement of a bankruptcy proceeding. Broadcast lenders are often quick to resort to judicial actions to foreclose their liens on the tangible assets of the broadcaster or stock of corporate broadcasters which has been pledged to the lender.

As the Commission knows, upon the appointment by the state court of a receiver for either the stock of a broadcaster or the assets of a broadcaster, the involuntary transfer of control mechanism will be available to the receiver and will permit the receiver

to do what the broadcast lender would be forbidden from doing directly, that is petitioning the Commission for a change of control in its own name, as involuntary assignee.

Thus, the inability of a broadcast lender to take a security interest in a broadcast license, rather than tempering the response of broadcast lenders, in all likelihood actually forces broadcast lenders to react more quickly and strongly than they would ordinarily react in a troubled loan situation. The Commission's current policy against encumbrances is probably detrimental to a troubled broadcaster, vis-a-vis the broadcaster's secured creditor, rather than beneficial.

The Broadcast Lender's Business Objectives and the Ridgely Decision.

The Commission should note that, unlike a seller who retains a reversionary interest in a broadcaster upon sale, a bank lender is in the business of loaning money and has neither an interest in, not the expertise to, own and operate radio stations. Because a bank's primary objective is to have its loan repaid, a bank will work with a troubled borrower toward that goal so long as the bank feels secure. When the bank feels insecure, the bank will act to protect its investment. The Commission should understand that this is a purely financial decision.

As a general rule, bank lenders will feel more secure when lending in the broadcast industry if bank lenders are confident that they will be able to enjoy the benefit of their bargain should a bankruptcy filing take place. A recent bankruptcy case, In Re

Ridgely Communications, Inc., Case No. 89-5-1705-JS, 1992 Bankr. LEXIS 567 (Bankr. Md. 1992) provides a theoretical basis for providing broadcast lenders with this comfort while maintaining Commission control over the identity of its licensees and the transfer of licenses.

The Ridgely Court, citing In Re Bill Welch, 3 F.C.C.R. 6502 (1988), determined that the Commission now recognizes that a broadcast license provides the broadcaster with some indicia of property rights, even if the broadcaster has no property interest in the frequency itself and cannot assign the license to a new licensee without Commission consent. In describing the implication of Welch, the Ridgely Court stated as follows:

> "The Commission acknowledged that a license confers certain private rights upon the licensee and that these rights may be sold for profit to a private party, subject to Commission approval. The Commission recognized that rights between licensees and the Commission are to be distinguished from rights between the licensee and a private party. It is this distinction that permits a licensee to receive a profit from the transfer of a license to a third party."

The Commission apparently anticipated the analysis of the Ridgely court in its notice of inquiry, asking commenters to address the legal implications that a conclusion that the private interests recognized in Welsh are available broadcast licensees may have under the Uniform Commercial Code.

The Ridgely court has answered this question. A broadcast lender who takes a uniform commercial code interest in the broadcaster's "general intangibles" captures an effective uniform commercial code lien in the right to collect the renumeration paid upon the assignment of that license. The Ridgely court imposes this effective lien upon the license itself, rather than through a lien on the assignment agreement as a separate contract or through a contract right to proceeds under the loan agreement. In reaching this conclusion, the Ridgely Court stated as follows:

> "For the foregoing reasons, this court holds that a creditor may perfect a security interest in a debtor's F.C.C. broadcasting license, limited to the extent of the licensee's proprietary rights in the license vis-a-vis private third parties. The right of the licensee crucial to this decision (and the only right recognized by the court in this case) is the right of the creditor to claim proceeds received by the debtor licensee from a private buyer in exchange for the transfer of the license to that buyer. The right to receive such proceeds is a private right of the licensee that constitutes a proprietary interest in which a creditor may perfect a security interest."

The Ridgely court is careful to note that the security interest which it recognizes does not purport to permit a secured creditor to foreclose on a broadcast license. Rather, the Court notes that the secured creditor is merely assured that it will not lose the

going concern value of the business if the borrower declares bankruptcy before the secured lender forecloses under state law procedures already recognized as effective by the Commission.

Conclusion.

The Ridgely Communications case illuminates a path of compromise between the positions of the Commission and more aggressive secured creditors who seek authority to foreclose on a broadcast license outright.

The Commission should ratify, and adopt as policy the holding in Ridgely, which gives lenders a carefully limited right to capture the renumeration received by the borrower/assignor upon assignment of a broadcast license, as an attribute of the broadcast license. By attributing this right directly to the broadcast license, the secured creditor will have a pre-petition lien which will survive the effect of Bankruptcy Code Section 552, as well as the effect of Bankruptcy Code Section 365(c)(2), which presently wreaks so much havoc on the expectations of a broadcast lender.

Based upon this analysis, Sheppard Mullin respectfully requests that the Commission adopt rules ratifying the position taken by the Bankruptcy Court in Ridgely Communications with respect to the ability of a secured lender to take a security interest in

the assignor's right to receive renumeration upon the assignment of a broadcast license as an attribute of the license itself.

Respectfully submitted,

SHEPPARD, MULLIN, RICHTER & HAMPTON
RICHARD L. SOMMERS
DAVID ISENBERG

By: _____
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